

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

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WISCONSIN ENERGY	:	
CORPORATION, INTEGRYS	:	
ENERGY GROUP, INC, PEOPLES	:	
ENERGY, LLC, THE PEOPLES GAS	:	
LIGHT AND COKE COMPANY,	:	
NORTH SHORE GAS COMPANY,	:	
ATC MANAGEMENT INC. and	:	
AMERICAN TRANSMISSION	:	<b>Docket No. 14-0496</b>
COMPANY LLC	:	
Application pursuant to Section 7-	:	
204 of the Public Utilities Act for	:	
authority to engage in a	:	
Reorganization, to enter into	:	
agreements with affiliated interests	:	
pursuant to Section 7-101, and under	:	
the Public Utilities Act to effectuate	:	
the Reorganization.	:	

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**POSITION STATEMENT OF THE  
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

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JESSICA L. CARDONI  
JOHN C. FEELEY  
MATTHEW L. HARVEY  
Office of General Counsel  
Illinois Commerce Commission  
160 North LaSalle Street, Suite C-800  
Chicago, IL 60601  
Phone: (312) 793-2877  
Fax: (312) 793-1556  
jcardoni@icc.illinois.gov  
jfeeley@icc.illinois.gov  
mharvey@icc.illinois.gov

April 13, 2015

*Counsel for the Staff of the  
Illinois Commerce Commission*

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**POSITION STATEMENT OF THE  
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, in accordance with the direction of the Administrative Law Judge (“ALJ”), respectfully submits its Position Statement in the above-captioned matter.

**I. STAFF OVERVIEW/SUMMARY**

The Illinois Commerce Commission (“Commission”) should not approve Wisconsin Energy Corporation, Integrys Energy Group, Inc., Peoples Energy, LLC, The Peoples Gas Light and Coke Company (“Peoples Gas” or “PGL”) and North Shore Gas Company

(“North Shore”) (collectively “Gas Companies”), ATC Management Inc. and American Transmission Company LLC (collectively “Joint Applicants” or “JAs”) application for authority to engage in a reorganization and to enter into agreements with affiliated interests, pursuant to Sections 7-101 and 7-204 of the Public Utilities Act (“Act”) unless the Commission adopts each of Staff’s conditions set forth in Appendix A, Appendix B<sup>1</sup>, and Appendix C to Staff’s Initial Brief.

Staff proposed thirty-one merger conditions on the JAs’ proposed reorganization. As of the filing of initial briefs, the JAs have proposed and/or agreed to forty-five conditions and/or commitments. (JAs IB, Appendix A.) Twenty-five of Staff’s thirty-one conditions (Staff IB, Appendix A.), were not opposed by the JAs in their Initial Brief. Four of Staff’s other conditions (Staff IB, Appendix B.) were also addressed by the JAs in their Initial Brief. While the JAs believe there is agreement between Staff and the JAs on all of the conditions (JAs IB, 9), this belief is not correct; there is not complete agreement on the four conditions, set forth in Appendix B to Staff’s Initial Brief. The final two conditions (Staff IB, Appendix C) proposed by Staff, arose from the recent initiation of Docket No. 15-0186. Staff and the JAs have reached agreement on two conditions related to this Commission investigation.

Table I below, lists Staff’s thirty-one proposed conditions and the corresponding or related JAs’ commitments/conditions and whether there is agreement between JAs and Staff on the condition/commitment.

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<sup>1</sup> In response to JAs initial brief, Staff made a revision to its Initial Brief, Appendix B, condition #3 and proposed an alternative condition to Initial Brief, Appendix B, condition #4.

**Table I**

<b>Description of Staff Proposed Condition<sup>2</sup></b>	<b>Staff Condition No., Source<sup>3</sup></b>	<b>JAs' Condition-Commitment No., Source</b>	<b>Is there agreement between Staff and JAs?</b>
1. Implementation of the recommendations contained in the final investigation report by Liberty on AMRP	#1, Appendix A	#9, Appendix A	Yes
2. PGL's cooperation with Staff and its consultants in the verification of the implementation of the Recommendations from the final investigation report by Liberty on AMRP	#2, Appendix A	#10, Appendix A	Yes
3. PGL provide semi annual written reports on the implementation of recommendations from the final investigation report by Liberty on AMRP	#3, Appendix A	#11, Appendix A	Yes
4. Condition #24 from Docket No. 06-0540	#4, Appendix A	#12, Appendix A	Yes
5. Gas Companies minimum capital investment levels	#5, Appendix A	#13, Appendix A	Yes
6. Future rate cases tracking of transaction costs	#6, Appendix A	#16, Appendix A	Yes

<sup>2</sup> The specific Staff condition language is set forth in the respective appendices to Staff's Initial Brief and is also set forth below.

<sup>3</sup> The source is the Appendix to the respective parties Initial Brief.

of the reorganization			
7. Transaction costs and transition costs to be separately tracked and identified	#7, Appendix A	#17, Appendix A	Yes
8. Push-down accounting entries	#8, Appendix A	#18, Appendix A	Yes
9. Any and all merger savings shall flow to ratepayers	#9, Appendix A	#19, Appendix A	Yes
10. No cost recovery from ratepayers for transaction costs incurred to accomplish reorganization	#10, Appendix A	#20, Appendix A	Yes
11. Cost recovery from rate payers for transition costs limited to savings	#11, Appendix A	#21, Appendix A	Yes
12. Interim WEC Energy Group AIA	#12, Appendix A	#22, Appendix A	Yes
13. Final WEC Energy Group AIA approved in Docket Nos. 12-0273 and/13-0612	#13, Appendix A	#23, Appendix A	Yes
14. FORM 21 Supplemental Information	#14, Appendix A	#24, Appendix A	Yes
15. Semi-annual progress report on status of conditions imposed in Docket No. 14-0496	#15, Appendix A	#25, Appendix A	Yes
16. WEC CEO Annual appearance before ICC addressing compliance with conditions	#16, Appendix A	#26, Appendix A	Yes

imposed in Docket No. 14-0496			
17. Separate credit facilities	#17, Appendix A	#27, Appendix A	Yes
18. Lending to non-utility affiliates	#18, Appendix A	#28, Appendix A	Yes
19. Prohibit guaranteeing of obligations to non-utility affiliates	#19, Appendix A	#29, Appendix A	Yes
20. WEC to notify ICC before increasing its proportion of non-regulated operations and indebtedness	#20, Appendix A	#30, Appendix A	Yes
21. NS and PGL register with SEC or in alternative provide a study showing costs and savings from not registering	#21, Appendix A	#32, Appendix A	Yes
22. Notification to ICC of JA's post merger capitalization	#22, Appendix A	#31, Appendix A	Yes
23. Study of appropriate capital structure	#23, Appendix A	#33, Appendix A	Yes
24. JAs commit to not seek recovery of rate case expense related to size adjustments	#24, Appendix A	#45, Appendix A	Yes
25. JAs to file copies of all credit rating reports, if Mr. Gorman's dividend restriction condition is rejected	#25, Appendix A	#34, Appendix A	Yes
26. PGL should be ordered to recommit to	#1, Appendix B	#5, Appendix A	No

complete AMRP by 2030			
27. FTE	#2, Appendix B	#2, Appendix A	No
28. JAs should be required to Implement a Pipeline Safety Management System (PSMS) at the Gas Companies	#3, Appendix B	#14, Appendix A	Yes <sup>4</sup>
29. PGL should be required to implement a program to move all Inside customer meters to accessible outside locations within 10 years from the effective date of the transaction	#4, Appendix B	#15, Appendix A	No <sup>5</sup>
30. JAs shareholders responsibility for expenses, costs, fines, penalties, fees or economic losses of any description whatever, arising out of unlawful or criminal activity discovered in the course of any investigation into the two anonymous whistleblower	#1, Appendix C	n/a	Yes <sup>6</sup>

<sup>4</sup> As discussed later on in this reply brief, Staff is willing to modify its Appendix B, condition #3 to allow Peoples Gas two years, instead of one year, from the transaction close to develop a PSMS plan.

<sup>5</sup> As discussed later on in this reply brief, Staff has an alternative condition with regard to Peoples Gas moving inside meters to the outside or to an accessible inside location.

<sup>6</sup> Subsequent to the filing of initial briefs, Staff and JAs reached agreement on the Staff conditions related to the Commission investigation in docket no. 15-0186.

letters currently the subject of a Commission-initiated investigation in Docket No. 15-0186			
31. Termination by WEC of employment or contractual relationships with individuals found to have been improperly or illegally involved in AMRP audit.	#2, Appendix C	n/a	Yes <sup>7</sup>

Jointly the Citizens Utility Board (“CUB”) and the City of Chicago (“City”), and on its own, the People of the State of Illinois by Attorney General Lisa Madigan (“AG”) have proposed some of their own conditions to which, in their opinion, the transaction should be subject. Staff either has not endorsed or has specifically taken no position on some of the Intervenor’s conditions. (Staff IB, 47 (Gorman proposed to condition dividends on AMRP targets.)). There are several conditions proposed by the AG and CUB/City which Staff opposes. Staff opposes the AG’s two proposed new rider conditions and the City/CUB proposed condition for a fixed customer charge freeze. These conditions were addressed in detail in Staff’s Initial Brief (Staff IB, 43-45). The AG also proposed in its initial brief a new condition. The AG’s condition would cap the residential revenue

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<sup>7</sup> Subsequent to the filing of initial briefs, Staff and JAs reached agreement on the Staff conditions related to the Commission investigation in docket no. 15-0186.

recovered through fixed charges at 40%. Staff opposes this condition for the reasons set forth below.

Staff's conditions are consistent with Section 7-204 of the Act and are necessary in order for the JAs to meet the statutory requirements of Section 7-204. Where a statute does not specifically place any burden of proof, courts have uniformly imposed on administrative agencies the common-law rule that the party seeking relief has the burden of proof. Scott v. Dept. of Commerce and Community Affairs, 84 Ill. 2d 42, 53; 416 N.E.2d 1082, 1088; 1981 Ill. Lexis 229 at 14; 48 Ill. Dec. 560 (1981). The term "burden of proof" includes the burden of going forward with the evidence, and the burden of persuading the trier of fact. People v. Ziltz, 98 Ill. 2d 38, 43; 455 N.E.2d 70, 72; 1983 Ill. Lexis 453 at 6; 74 Ill. Dec. 40 (1983). The burden of persuading the trier of fact does not shift throughout the proceeding, but remains with the party seeking relief. Ambrose v. Thornton Twp. School Trustees, 274 Ill. App. 3d 676, 680; 654 N.E.2d 545, 548; 1995 Ill. App. Lexis 614 at 7-8; 211 Ill. Dec. 83 (1<sup>st</sup> Dist 1995), *app. den.*, 164 Ill. 2d 557 (1995).

The Staff contested conditions in Appendix B to Staff's initial brief, are two of Staff witness Smith's conditions and two of Staff witness Lounsberry's conditions. Mr. Lounsberry's conditions are necessary for Joint Applicants to meet the requirement of Section 7-204(b)(1) of the Act. Part (b)(1) of Section 7-204 requires that the Commission find that the reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. With respect to Mr. Lounsberry's contested conditions, Joint Applicants: (1) refuse to recommit to complete Peoples Gas' Accelerated Main Replacement Program ("AMRP") by 2030 and (2) refuse to agree to minimum Full Time Equivalent Employee ("FTE") levels of: (a) **1,356** at

Peoples Gas, (b) **177.7** at North Shore and (c) **493** for Integrys Business Support for two years after close of the reorganization transaction and refuse to agree that to the extent there are additional hires for personnel recommended by the Liberty Consulting Group's ("Liberty") Final Report on AMRP, those hires will not count toward the previously mentioned FTEs and Joint Applicants will separately track the AMRP hires recommended by the Liberty Report on AMRP. Mr. Smith's conditions are necessary to protect the interests of North Shore and Peoples Gas and their customers as required by Section 7-204(f) of the Act. Mr. Smith's proposed conditions, which Joint Applicants have not agreed with in their entirety concern the movement of insider meters to the outside by Peoples Gas and the implementation of a Pipeline Safety Management System.

Staff proposed two post-hearing conditions in Appendix C to its Initial Brief. Both of these conditions result from the Commission-initiated Docket No. 15-0186, which was initiated on March 11, 2015, to investigate two anonymous whistleblower letters and related illegal or improper activity sent to Commission Staff and attorneys. The two letters allege numerous illegal and improper acts and practices conducted by employees at Peoples Gas, WEC and Integrys. The allegations relate to the acquisition/merger process, management of the AMRP, and related criminal and fraudulent activity. Staff's first proposed post-hearing condition is that the JAs shall not be permitted to recover through rates any expenses, costs, fines, penalties, fees or economic losses of any description whatever, however incurred, arising out of improper, unlawful or criminal activity discovered in the course of any investigation related to these letters or related activities. The term investigation is not limited to the Commission-initiated investigation in

Docket No. -15-0186 but would include any related state or federal investigation (“Investigation”).

This condition is necessary to protect the interest of the Gas Companies’ customers within the meaning of Section 7-204(f) of the PUA. In the event that the Commission’s investigation does in fact reveal wrongdoing or culpable negligence on the part of officers, employees, agents or representatives of WEC, Integrys or the Gas Companies, ratepayers should not be required to bear the costs of such misconduct; rather, shareholders should do so. If, for example, the Investigation reveals that the Gas Companies or Integrys have failed to put in place financial controls adequate to prevent inflation of costs by contractors, the belated implementation of such controls should not be borne by ratepayers. Certainly, shareholders, rather than ratepayers should absorb all fines and penalties.

The second condition relates to the claims in the letters alleging WEC involvement and misconduct in the AMRP Investigation. Staff urges the Commission to require WEC to terminate from employment or contractual relationship any officers, employees, agents or representatives of JAs found to have attempted to frustrate or improperly influence the AMRP audit, or any officers, employees, agents or representatives of JAs otherwise found to have committed misconduct. This condition is necessary because, if there have indeed been attempts to frustrate the conduct of a lawful Commission-ordered audit, it is simply not in the public interest – in fact, it is directly contrary to the public interest – that those responsible be trusted to remain in the JAs’ employ or in a contractual relationship with JAs.

Subsequent to the filing of initial briefs, Staff and JAs came to agreement on Staff's two investigation related conditions discussed below.

As noted above, Section 7-204(f) of the Act allows the Commission to impose any "terms, conditions, or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers." 220 ILCS 5/7-204(f). Staff's proposed conditions, discussed below are necessary to protect the interests of Peoples Gas, North Shore Gas, and its ratepayers.

## **II. STAFF ARGUMENT**

### **A. Section 7-204 Issues Contested or Partially Contested by JAs**

#### **1. 7-204(b)(1)**

Section 7-204(b)(1) of the Act provides that in reviewing any reorganization the Commission must find that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." (220 ILCS 5/7-204(b)(1).). Staff witness Lounsberry proposed several conditions and recommendations in order for him to be able to recommend that JAs' application met the requirement of Section 7-204(b)(1). (Staff Ex. 9.0, 3-5.) The conditions and commitments were subsequently narrowed down or refined into seven conditions. (Id., 6-7.) JAs did not agree with two of Mr. Lounsberry's conditions. One of the conditions not agreed to is a recommitment by JAs for Peoples Gas to complete AMRP by 2030 and the other relates to FTEs. The five agreed to conditions were set forth in detail Appendix A to Staff's initial brief. The agreed to conditions are:

1. Implementation of the recommendations contained in the final investigation report by Liberty on AMRP

With respect to each recommendation contained in the final report of the investigation of Peoples Gas' AMRP completed at the direction of the Commission in its June 18, 2013 Order in Docket No. 12-0512 under the authority granted in Section 8-102 of the Act (220 ILCS 5/8-102), Peoples Gas shall evaluate the recommendation and implement it if the recommendation is possible to implement, practical and reasonable from the standpoint of stakeholders and Peoples Gas customers, and cost effective. Implementing a recommendation means taking action per a recommendation. If Peoples Gas determines that a recommendation is not possible, practical, and reasonable, including that the recommendation would not be cost-effective or would require imprudent expenditures, Peoples Gas shall provide an explanation of Peoples Gas' determination with all necessary documentation and studies to demonstrate to the satisfaction of the Commission Staff that strict implementation of the recommendation is not possible, practical, or reasonable, along with an alternative plan to accomplish the goals of the recommendation as fully as is possible, practical, and reasonable. In the event that Peoples Gas and Commission Staff cannot reach agreement as to whether a recommendation should be implemented and/or how it should be implemented, Peoples Gas may file a petition to obtain the Commission's determination as to whether and/or how the recommendation is to be implemented. (JAs Ex. 15.1 REV #9; Staff IB, Appendix A, #1.)

2. PGL's cooperation with Staff and its consultants in the verification of the implementation of the recommendations from the final investigation report by Liberty on AMRP

Peoples Gas will cooperate fully with the Commission's Staff and consultants as they work to verify that Peoples Gas has implemented the recommendations in the final report on the Peoples Gas' AMRP investigation to the extent it is determined they should be implemented pursuant to Condition #\_\_, above. Cooperation means to provide requested personnel who are reasonably involved in, connected to, and/or relevant to the AMRP and/or the Liberty audit for interviews in a timely manner in which the personnel interviewed shall provide, to the best of their ability, accurate and complete non-privileged information in response to questions asked, to answer written questions in a reasonable time with accurate and complete non-privileged information, and to make all non-privileged information, equipment, work sites, work forces and facilities available for inspection upon reasonable request. (JAs Ex. 15.1 REV #10; Staff IB, Appendix A, #2.)

3. PGL provide semi annual written reports on the implementation of recommendations from the final investigation report by Liberty on AMRP

Peoples Gas will provide written reports to the Commission Staff on or before January 1 and July 1 of each year, beginning in the year 2018 and ending only after the completion of the AMRP or any successor program that replaces the AMRP, about any change in implementation of the recommendations in the final report of the investigation of Peoples Gas' AMRP to the extent it is determined they should be implemented pursuant to Condition #\_\_, above. An officer of Peoples Gas shall provide written verification of the accuracy and completeness of each report. (JAs Ex. 15.1 REV #11; Staff IB, Appendix A, #3.)

4. Condition #24 from Docket No. 06-0540

Gas Companies shall cease their reporting on Condition #24 from Docket No. 06-0540. (JAs Ex. 15.1 REV #12; Staff IB, Appendix A, #4.)

5. Gas Companies minimum capital investment levels

The Joint Applicants agree to make at least \$1 billion in capital expenditures for Peoples Gas and at least \$43 million in capital expenditures for North Shore during the 2015 through 2017 period. The Joint Applicants shall provide a running total of the Gas Companies capital expenditures in its semi-annual compliance report to the Commission. (JAs Ex. 15.1 REV #13; Staff IB, Appendix A, #5.)

All of Mr. Lounsberry's conditions must be imposed on the JAs in order for the JAs' reorganization to not diminish the utility's ability to provide adequate, reliable, efficient and safe and least-cost public utility service. The support for the two contested conditions proposed by Mr. Lounsberry follow is set forth below.

**a. Recommit to complete AMRP by 2030**

Section 7-204(b)(1) of the Act requires the Commission to find that the reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. (220 ILCS 5/7-204(b)(1).) Approval of the JAs' petition should be conditioned upon JAs recommitting to complete Peoples Gas' AMRP by 2030. Such a recommitment would be consistent with the Commission's order in Docket Nos. 09-0166/09-0167 (Cons.) ("2009 Rate Cases"). (Staff Ex. 2.0, 13.) Without

such recommitment by JAs, there will be a diminution in Peoples Gas providing adequate, reliable, efficient, safe and least-cost public utility service. An extension of the AMRP 2030 end date would have serious safety implications. (Staff Ex. 8.0, 8.) AMRP was ordered by the Commission for only pipeline safety reasons and AMRP's end date should not be extended without giving serious consideration to the pipeline safety implications of an extension. (Id., 8-9.)

The JAs do not accept this assessment. Instead, the JAs claim Peoples Gas' commitment to AMRP in the 2009 Rate Cases order was to a 20-year program, but dependent upon certain cost recovery. The JAs argue that the Commission 2009 Rate Cases order linked the timeline for AMRP completion with the approval of the Rider ICR cost recovery mechanism. (JAs Ex. 9.0, 3) The JAs then argue that, because the Illinois Appellate Court held that the Commission lacked the authority to approve Peoples Gas' Rider ICR<sup>8</sup>, the Commission direction for completion of AMRP by 2030 is no longer applicable. (Id., 4.)

The JAs' argument should be rejected. The 2009 Rate Cases order determined that completion of AMRP by 2030 was necessary and in the public interest. (Staff Ex. 9.0, 11.) Having made that determination, the Commission required that Peoples Gas complete the AMRP by the year 2030. Id. Only then did the Order authorize Rider ICR to allow Peoples Gas a means to obtain recovery of its AMRP costs versus Peoples Gas needing to seek recovery via periodic rate cases. Id. The issue of whether there is a need

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<sup>8</sup> People v. Illinois Commerce Commission, 2011 IL App (1<sup>st</sup>) 100654.

to accelerate replacement of cast and ductile iron mains is and always has been separate and distinct from the issue of the appropriate recovery mechanism. (Staff Ex. 9.0, 11-12.)

The Commission concluded the following in the 2009 Rate Cases order:

We are told by Staff that an accelerated modernization program for the Company is shown to be a necessity that neither the Commission nor PGL can ignore. Mr. Stoller points out that the Company's system is old, antiquated and approaching the point where further aging will become an emergency matter rather than one which can reasonably be planned and executed. It is important to Staff that the replacement program begins very soon in order to keep the system safe for the citizens of Chicago. This echoes the City's similar position of public safety in urging for our adoption of ICR.

On the other hand, we observe PGL and the AG to dispute Staff's assertions. They each point out that there is nothing to show that the Company's system is not being operated safely at the present time. We see nothing in these arguments to contradict or explain away the testimony of Mr. Stoller or PGL's expert Mr. Marano or to give confidence to the Commission for maintaining the *status quo*.

While Mr. Marano did say that PGL has prudently managed its system and the risks it poses are well in line with acceptable industry measures, his testimony further tells us that there is a need to pursue a more accelerated approach of upgrading this system to prevent or mitigate foreseeable future risk of system and asset failure. The Commission recalls well his point that costs will only rise as matters get worse or if an emergency were to erupt.

Immediate safety concerns are not what drive our concern. We expect PGL to stay attentive to the prudent operation of its system. No company wants to come before the Commission and explain away service failures or worse events. What we glean from Mr. Marano's testimony is that PGL's performance is fine to this point - but performance alone will not obliterate the risks. The Commission does not condone such a band-aid approach nor do we consider it safe for any length of time. In other words, a band-aid will not suffice in the situation where a cut is in serious need of stitching.

North Shore Gas Company and the Peoples Gas Light and Coke Company, ICC Order Docket Nos. 09-0166/0167 (Cons.), 193, January 21, 2010 (emphasis added). The 2009 Rate Cases Order further indicated:

Due to the many benefits that the accelerated plan provides to ratepayers, the Commission is of the opinion that time is of the essence and hereby requires completion of the acceleration plan project by 2030. Any variance from this completion date will require the Company to seek the Commission's approval.

(Id. at 196.) (emphasis added). Nothing in the 2009 Rate Cases order states or even suggests that AMRP's 2030 end date was dependent upon rider cost recovery. Instead, the order provides that any change from that 2030 end date would require Commission approval. This is not the appropriate case for the Commission to grant that approval.

The JAs proposed the following commitment regarding this issue:

Peoples Gas will continue the Accelerated Main Replacement Program ("AMRP"), assuming it receives and continues to receive appropriate cost recovery, with a planned 2030 completion date. (JAs Ex. 15.1 REV #5.)

The Commission should reject the JAs' commitment because it is not consistent with the Commission's 2009 Rate Cases order and the Commission instead should adopt Staff's proposed language for this issue. Staff's proposed commitment language is as follows:

Joint Applicants will reaffirm Peoples Gas' commitment to the Commission in Docket Nos. 09-0166/09-0167 (Consol.) to complete the Accelerated Main Replacement Program ("AMRP") by the end of 2030. (Staff Ex. 9.0, 15; Staff IB, Appendix B, #1.)

The AG does not support a 2030 end date for AMRP, and therefore proposes the condition that the AMRP 2030 completion timeline be reassessed. (AG IB, 59) However, the AG omits one vital consideration in arguing that "the Commission must require the Joint Applicants to commit to improving the current operation of the AMRP by reassessing the scale and timeline of the program to a manageable level." (Id., 59-60.) As Staff witness Harold L. Stoller testified, the

AG (and other intervenors) ignore the pipeline safety implications of any decision to delay AMRP completion beyond the Commission's mandated 2030 date. (Staff Ex. 8.0, 3.) Specifically, the AG ignores the nature of the cast and ductile iron piping materials that lose their strength over time through the processes of graphitization and corrosion. (Id., 5.) The age of the cast iron, chemistry of the soil around the pipe, electrical current resistivity or conductivity of the soil, stray electrical current presence in the soil, soil moisture and aeration fluctuations, and corrosion rates are factors that all can contribute to unpredictable graphitization rates. (Id., 4-5.) Both cast and ductile iron are also subject to corrosion which causes the iron pipe in any gas system to become less strong and more brittle. Id. Additionally, the congested utility underground in Chicago, combined with the frigid winter climate, causes soil disturbances that only further compromise the integrity of these obsolescent and in some cases ancient piping materials. (Id., 7-8) This confluence of factors has profound public safety implications, potentially compromising the life, health, safety and property of Peoples' customers and those who reside in its service territory. Id. And, that risk, while it cannot be precisely quantified, and regardless of how unquantifiable it might be, increases with the passage of time. (Id., 8.) Extending the end date for AMRP will most certainly increase that risk, and the AG's proposed condition should be rejected. (Id., 9.)

#### **b. Full Time Equivalent Employees**

The number of employees the JAs will retain after the close of the reorganization transaction is vital in determining whether the proposed reorganization will diminish the Gas Companies' ability to provide adequate, reliable, efficient, safe and least-cost public

utility service. (220 ILCS 5/7-204(b)(1).) Reducing employee levels below the levels approved by the Commission from the Gas Companies most recent rate cases could cause detrimental results for ratepayers. As a condition for approval of the reorganization, the Commission should require the JAs to enter into a commitment to retain for two years after the closing of the proposed organization the FTE levels the Commission approved in Docket Nos. 14-0224/14-0225 (Cons.) (“2014 Rate Cases”). Related to that condition and commitment, the Commission should order that any recommendations from the Liberty review of Peoples Gas’ AMRP that result in additional headcount shall not count toward the existing FTE commitment values.

In its direct testimony, the JAs proposed a commitment to maintain 1,953 full time FTE positions in Illinois for two years after the closing of the proposed reorganization. (JAs Ex. 1.0, 18.) This proposal however, was lacking in clarity for several reasons. First, the JAs’ proposed FTE amounts were an aggregate amount, not broken out between North Shore, Peoples Gas, and Integrys Business Support. (See Staff Ex. 2.0, 30.) Second, the number of FTEs proposed by the JAs was not consistent with the projected FTE levels that the Gas Companies forecasted in their 2014 Rate Cases. Id. Finally, the potential exists that the Liberty Consulting Group’s audit of Peoples Gas’ AMRP could result in recommendations to increase staffing levels on some areas of the Company. Staff witness Eric Lounsberry requested the JAs add to the phrasing “Peoples Gas agrees and commits that it shall implement any increased staffing levels recommended by Liberty audit recommendations as an overall increase in the agreed upon FTE levels for Peoples Gas” to address this concern. (Id., 29-30.)

The JAs responded by indicating their 1,953 FTE commitment is a “floor level” commitment for the post-merger company. (JAs Ex. 6.0, 23.) As such, they argued this commitment does not mean that the WEC Energy Group is looking to target this level of Illinois employment to this figure and that the needs of the Gas Companies to provide adequate, reliable, efficient, safe, and least-cost utility service and the shared service company in Illinois may require more than the commitment level. Id. The JAs also claim that in the FTE levels the Gas Companies forecasted within the 2014 Rate Cases, 1,356 for Peoples Gas and 177.7 for North Shore, are not inconsistent with the JAs’ floor-level commitment. (Id., 23-24.)

The JAs’ “floor level” commitments break down to 1,294 FTE for Peoples Gas and 166 FTE for North Shore. (Staff Ex. 9, 17.) Significantly, these figures represent reductions of 4.6% ( $1,356 - 1,294 = 62$ ,  $62/1,356 * 100 = 4.6$ ) and 6.6% ( $177.7 - 166 = 11.7$ ,  $11.7/177.7 * 100 = 6.6$ ), respectively, in Peoples Gas and North Shores 2015 forecasted manpower levels from the 2014 Rate Cases. Id. While the Order from the 2014 Rate Cases provides the Gas Companies with their projected 2015 FTE levels (North Shore and Peoples Gas, ICC Order Docket Nos. 14-0224/0225 (Cons.), 59 and 63, January 21, 2015) the JAs have failed to provide any rationale behind why the Commission ordered levels should be departed from.

While JAs argue for reduced FTE levels in this reorganization case, the Gas Companies took the opposite position in the 2014 Rate Cases. In the 2014 Rate Cases, Peoples Gas forecasted an increase in its headcount from 1,306 FTE employees at the end of 2013 to 1,356 employees at the end of 2014 and throughout the entire 2015 test year. (Staff Ex. 9.0, 18; North Shore and Peoples Gas, ICC Order Docket Nos. 14-

0224/0225 (Cons.), 55, January 21, 2015.) Peoples Gas based its forecast on an increased need for employees to address stricter standards of compliance with pipeline safety rules as well as increased work on AMRP. (Staff Ex. 9.0, 18.) Next, Peoples Gas identified thirty-three positions for which interviews were currently being conducted. Id. The Gas Companies also noted that approximately twenty positions will be filled by utility workers who graduated from the Power for America training program at Dawson Technical Institute in Chicago in September 2014. Id. Finally, the Gas Companies noted that the utility workers participate in a six-week long internship through Peoples Gas, wherein the workers are assigned to a district shop and are evaluated by management staff, supervisors, and peer and Peoples Gas seeks to hire those individuals who successfully complete the internship program as full-time utility workers. (Id., 18-19.)

North Shore also forecasted an increase in its headcount to 178 FTEs throughout 2014 and 2015 in the 2014 Rate Cases. (Staff Ex. 9.0, 19; North Shore and Peoples Gas, ICC Order Docket Nos. 14-0224/0225 (Cons.), 59, January 21, 2015.) To support its increased test-year employee levels, North Shore provided information that it had conducted interviews to fill thirteen open positions, and that it anticipated it would fill an additional two positions in the fourth quarter of 2014. (Staff Ex. 9.0, 19.) In addition, North Shore noted that the increased employee levels are necessary and reasonable, as the Company's current employee level has forced it to operate at levels below the budgeted headcount, resulting in an inefficient reliance on overtime and contractors to supplement its workforce. Id.

The JAs claim Staff's proposed FTE commitment language changes the nature of the commitment by removing the Illinois component from the FTE commitment and

limiting the flexibility the WEC Energy Group needs to operate its business efficiently. (JA Ex. 15.0, 14-15.) The JAs also claim that Staff's proposed FTE commitment would limit the ability of the WEC Energy Group to seek synergy savings and reduce potential duplication in the shared services company. (Id., 15.) Further, the JAs claim the implementation of recommendations from the final Liberty investigation report are better left addressed by the already agreed-upon conditions concerning their implementation. Id. Moreover, the JAs argue that the proposed language presupposes that any Liberty recommendation for the hiring of additional personnel must be in addition to forecasted 2015 test year FTE levels. Id. The JAs contend that the proposed language would foreclose the possibility of additional hires being recommended as a replacement for existing personnel with the incorrect or inadequate skillsets. Id. Alternatively, a different recommendation might propose eliminating certain positions to increase efficiency, leading to the recommendations as a whole providing for no net change in employment levels. Id.

The JAs claim the best alternative for an FTE commitment is the one they proposed in their original filing:

The Joint Applicants agree that the WEC Energy Group will maintain a minimum of 1,953 FTEs in the State of Illinois for two years after the Reorganization closes. (Id., 15; JAs Ex. 15.1 REV #2.)

The JAs also provided an alternative FTE commitment language should the Commission determine the employment levels at the Gas Companies themselves are more significant than overall employment levels maintained in the State of Illinois. The JAs stated they can agree to a condition to maintain a minimum level of employment at the Gas Companies based upon the 2015 test year levels for which recovery was

approved in their 2014 Rate Cases (1,356 FTEs for Peoples Gas and 177.7 FTEs for North Shore). (JA Ex. 15, 16) This alternative FTE commitment is:

[Alternative Condition] The Joint Applicants agree that the Gas Companies will maintain at least 1,534 FTEs for two years after the Reorganization closes. (Id.; JAs Ex. 15.1 REV # 2.)

The Commission should reject the JAs' arguments. Likewise, the Commission should reject both of the JAs' proposed conditions/commitments language. JAs indicate that they do not expect to implement any large-scale layoffs after the reorganization closes. (JAs Ex. 1.0, 17.) In particular, the JAs state that the motivation behind many corporate transactions is a belief that consolidation can result in large, quickly-achieved cost savings, usually through a massive reductions in employee headcount. Id. The JAs point out that this proposed transaction does not fit that mold; instead the transaction is primarily motivated by, and makes business sense based on, the fact that it results in a combined company with strong cash flows that can be prudently invested in needed energy infrastructure. Id. The JAs also state that the Gas Companies' employees will benefit by becoming part of an organization that is better equipped to maintain its independence and cost-effectiveness in the rapidly changing energy business. Id. Next, the JAs note that to minimize disruption and ensure a deliberate transition to combined operations, Wisconsin Energy is not planning the sort of reduction in force that occurs in many corporate consolidations. Id. Instead, the JA claimed they expect the vast majority of any reductions in employee headcount to occur over time through attrition – *i.e.*, voluntary decisions by employees to leave the company, such as retirements and voluntary departures. Id. All of this is contradicted by the JAs' so-called "floor-level"

commitment in this reorganization proceeding, which would result in a reduction in the number of FTEs.

The JAs have never provided any definitive plans for how they will operate the Gas Companies going forward, or what if any staffing level reductions they identified. In fact, JAs provided insufficient information to form a conclusion regarding any longer-term effect of the proposed reorganization. (Staff Ex. 2.0, 8-9.) What is known is that the Gas Companies argued in the 2014 Rate Cases for specific FTE levels, and these are the same levels that the Commission should hold the JAs to maintain in their proposed FTE commitment language. (Staff Ex. 9.0, pp. 20-21.) Finally, Staff's proposed FTE commitment levels for Integrys Business Support (493 FTEs) equal those originally proposed by the JAs for Integrys Business Support when the JAs' aggregate totals are broken down into the individual components. (Staff Ex. 2.0, 27.)

Based upon the above, the Commission should require the JAs to commit to the language below regarding the levels of FTE for its Illinois operations.

Joint Applicants agree to maintain a minimum of 1,356 FTEs for Peoples Gas, 177.7 FTEs for North Shore, and 493 FTEs for Integrys Business Support for two years after the close of the transaction. The Joint Applicants also agree to the extent it implements any recommendations in the final report on the Peoples Gas' AMRP investigation that require the hiring of additional personnel, those additional personnel shall not count toward the FTE values previously identified and the Joint Applicants shall track them separately. (Staff Ex. 9.0, 21; Staff IB, Appendix B, #2.)

## **2. 7-204(f)**

### **a. The Commission Should Require the JAs to Implement a Pipeline Safety Management System for the Gas Companies as a Condition of Approval of the Transaction**

The record in this proceeding demonstrates that. PGL has, over an extended period, been the subject of a number of Notices of Probable Violation ("NOPVs") issued

by the Commission's Gas Pipeline Safety Program Staff, alleging apparent violations of federal regulations governing gas pipeline safety. (Staff Ex. 3.0, 10.) Pipeline Safety Staff issued NOPVs for apparent violations of pipeline safety regulations governing corrosion control procedures, leak survey procedures, improperly abandoning facilities, inadequate record keeping, failure to follow procedures for numerous requirements, pressure testing, emergency procedures, customer notification, qualifying employees to fabricate pipe joints, public awareness, reporting safety-related conditions, hazardous leak repairs, resolving unsafe conditions, operator qualifications and plastic pipe overexposure to ultraviolet light. Id. These NOPVs demonstrate a pattern of failure at PGL: more specifically, failure to properly identify regulatory requirements, failure to adequately follow procedures, failure to provide adequate supervision, and failure to provide adequate quality assurance. (Id., 11.) These failures can be attributed at least in part to the fact that PGL has had continual issues communicating areas of concern within its own organization. Id.

The record in this proceeding further identifies three particularly serious violations of pipeline safety requirements by PGL. (Staff Ex. 3.0, 6-10.) Two of these violations resulted in injuries to persons, and one in a fatality. (Id., 8-9.) PGL paid fines totaling \$1.3 million to resolve these violations, and in each case was ordered to revise its pipeline safety policies and procedures. (Id., 7-9.) PGL was also required to retain a consultant to investigate PGL's compliance with pipeline safety regulations, including evaluation of PGL's record-keeping procedures, substantiation of PGL's pipeline safety inspection records, and verification of recorded pipeline safety conditions in the PGL system,

followed by an audit of PGL's continuing actions to implement recommended improvements to its pipeline safety program. (Id., 7-8)

Given this history, it is vital that the Commission condition approval of the transaction upon PGL being required to take positive steps to improve its pipeline safety performance, in order to protect the interests of PGL and its customers consistent with Section 7-204(f) of the Act. More specifically, the Commission should require PGL to implement a Pipeline Safety Management System ("PSMS") in accordance with American Petroleum Institute Recommended Practice 1173 ("RP 1173"). (Staff Ex. 3.0, 15-16.)

RP 1173<sup>9</sup> provides guidance to pipeline operators for developing and maintaining a PSMS. (Staff Ex. 3.0, 16.) The elements of RP 1173 are structured to minimize nonconformity with other pipeline safety processes and procedures. Id. While RP 1173 may include some elements of other management systems (such as those specific to environmental management, occupational health, personnel safety management, financial management, or insurance risk management), it does not include all requirements specific to those systems. Id. RP 1173 may be used either in conjunction with or independent of other industry-specified documents. Id. Finally, RP 1173 builds upon and augments existing requirements and is not intended to duplicate requirements of any other consensus standards or regulations. Id.

Managing the safety of a complex process requires a system of efforts to address multiple, dynamic activities and circumstances. (Staff Ex. 3.0, 16.) Pursuing the industry-wide goal of zero pipeline safety incidents requires comprehensive, systemic effort. Id. Some efforts within a PSMS are directed to a specific need or activity. Id. For example,

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<sup>9</sup> It is anticipated that RP 1173 will be available in its final form this spring. (Staff Ex. 3.0, 19.)

non-punitive reporting of near misses is one element that can be used to identify potential risks and initiate proactive measures. Id. Though many process incidents are relatively infrequent, they can still lead to serious consequences; indeed, as noted above, they can lead to fatalities. (Id., 18-19) Accordingly, other elements of a safety management system address the need to continuously operate safely and improve safety performance. (Id., 19.) Effective communication between various departments to identify potential and interactive threats can produce effective risk reduction. Id.

Such indirect broader-based efforts should include each of the following:

- a. demonstrating management commitment;
- b. structuring pipeline safety risk-management decisions;
- c. increasing confidence in risk prevention and mitigation;
- d. providing a platform for sharing knowledge and lessons learned; and
- e. promoting a safety-oriented culture.

(Staff Ex. 3.0, 17.)

A PSMS should be based upon the following principles:

- a. Commitment, leadership, and oversight from top management are vital to the overall success of a PSMS;
- b. A safety-oriented culture is essential to enable the effective implementation and continuous improvement of safety management system processes and procedures;
- c. Risk management is an integral part of the design, construction, maintenance, and operation of a pipeline;
- d. Pipelines are designed, constructed, operated, and maintained in a manner that complies with Federal, state, and local regulations, and conform to applicable industry codes and consensus standards with the goal of reducing risk, preventing releases, and minimizing the occurrence of abnormal operations;
- e. Defined operational controls are essential to the safe operation and maintenance of pipeline;

- f. Incident response improves the likelihood of protection of life and property and minimizes adverse environmental consequences;
- g. The creation of a learning environment for continuous improvement is achieved by investigating incidents thoroughly, fostering non-punitive reporting systems, and communicating lessons learned;
- h. Periodic assessment of risk management effectiveness and pipeline safety performance improvement, as well as audits, is essential to ensure effective PSMS performance; and
- i. Pipeline operating personnel throughout the organization must effectively communicate and collaborate with one another. Further, communicating with service providers to share information that supports decision making and completing planned tasks (processes and procedures) is essential.

(Staff Ex. 3.0, 17-18.)

Implementation of a PSMS at PGL would improve PGL's pipeline safety performance. (Id., 18.) A PSMS would improve PGL's internal lines of communication and would require all facets of the organization to better understand their roles and what is required of them. Id. Given the record evidence regarding PGL's pipeline safety performance, implementation of such a system as a condition of approval of the transaction is clearly necessary to protect the interests of the Gas Companies and their customers, within the meaning of Section 7-204(f) of the Public Utilities Act. Id.

PGL states that, while it generally supports implementation of RP 1173, it is "hesitant" to commit to doing so. (JA Ex. 11.0, 3.) It argues that RP 1173 exists only in draft form at this time, and no regulator in any other jurisdiction has to date required its use. Id. Accordingly, asserts PGL, it has no examples of successful programs to emulate. Id. PGL further argues that RP 1173 is a "collection of concepts" which is "vague[]" and subjective[.]" (Id., 4-5.) Accordingly, PGL asserts that it cannot be certain how the Commission will judge compliance with the implementation requirement if it is imposed

as a merger condition. Id. It further argues that implementation of RP 1173 will be costly and burdensome. (Id., 5-6.) PGL proposes to work with Staff on developing a stipulation concerning the development and implementation of a PSMS. (Id., 3; JA Ex. 20.0, 2.)

PGL's concerns lack merit. While initial implementation of a PSMS will not resolve the various deficiencies at PGL, as PGL encounters issues not currently resolved by the PSMS, steps can be taken to strengthen the program and thus implement a stronger PSMS. (Staff Ex. 10.0, 2.) Accordingly, PGL's concern that it has no other PSMS to emulate is ill-taken, since PGL will, over the course of time, have its own experience to draw on. It is likely that the program will be markedly different in 10 years from the PSMS originally adopted. Id. As to costs and burdens, it seems likely that the successful operation of a PSMS is likely to result in a substantial reduction in the fines that PGL is required to pay for violations the Illinois Gas Pipeline Safety Act; as noted above, the record reflects that PGL was fined \$1.3 million to resolve only three violations. Such savings are likely to offset at least some of the costs of implementing a PSMS. Likewise, as noted above, PGL has in the past been required to retain consultants to identify defects in its pipeline safety policies, procedures and practices. To the extent that a PSMS improves PGL's pipeline safety performance without requiring the retention of consultants, PGL can realize significant offsetting savings there as well. Further, arguing that implementing a PSM will be burdensome; PGL's pipeline safety record is such that it must be required to undertake certain burdens to improve it.

In its Initial Brief, the JAs proposed the following condition:

The Joint Applicants shall work with Staff to plan and develop a Pipeline Safety Management System for the Gas Companies during the two years after the close of the Reorganization.

(JAs' IB, Appendix A, #14.) The main difference between Staff's proposed condition and the JAs is the time frame for a draft plan to be prepared by the Gas Companies. The JAs propose two years, while Staff proposes one year. Staff's condition also makes clear that the plan is subject to Commission approval. The JAs' condition #14 does not address this point. Staff is encouraged by the JAs' agreement to develop a PSMS, and while in Staff's opinion a draft plan could be developed within one year from the close of the transaction, if the Gas Companies in fact need two years to develop such a draft plan, then Staff will defer to the Gas Companies on that issue provided that the plan is fully subject to Commission approval. Accordingly, Staff proposes the following revision to condition #3 of Appendix B to Staff's Initial Brief, concerning PSMS:

The JAs shall work with Staff to implement a PSMS for the Gas Companies. The JAs shall produce a draft PSMS for Commission approval within one year two years of the close of the transaction.

**b. The Commission Should Order PGL to Implement a Program to Move All Inside Customer Meters to Accessible Outside Locations Within 10 Years From the Effective Date of the Transaction**

Federal regulations enforced under the Illinois Gas Pipeline Safety Act require operators of gas distribution systems, such as PGL, to conduct periodic leakage surveys and periodically monitor facilities for atmospheric corrosion. (See, *generally*, 49 C.F.R. §§192.481; 192.723.) More specifically, PGL is required to conduct leakage surveys in business districts "at intervals not exceeding 15 months, but at least once each calendar year[.]" and outside of business districts "at least once every 5 calendar years at intervals not exceeding 63 months." (49 C.F.R. §723(b)(1), (b)(2).) Further, PGL must inspect exposed pipelines for evidence of atmospheric corrosion "[a]t least once every 3 calendar

years, but with intervals not exceeding 39 months[.]<sup>10</sup> (49 C.F.R. §192.481(a).) Each of these regulations applies to gas meter locations, including insider meters. (Staff Ex. 3.0, 11.)

PGL committed to complete required inspections of all inside meters by 2005. (Staff Ex. 3.0, 12.) PGL, however, failed to do so, and the Commission cited PGL for failure to comply with these requirements in 2005. (See Citation Order, Illinois Commerce Commission On Its Own Motion -vs- The Peoples Gas Light and Coke Company: Citation for alleged violation of Commission rules regarding leakage surveys, ICC Docket No. 05-0341 (June 2, 2005).) In its final Order in that proceeding, the Commission found that in 2000, 2001, 2002, 2003 and 2004 PGL was unable to comply with the Inside Safety Inspection program (“ISI”) which includes inspecting all company owned inside piping, that is, inside customer premises, up to and including the outlet of the gas meter for both leakage and atmospheric corrosion. (Staff Ex. 3.0, 12.) The Order further stated that, as an example of PGL’s ISI failures in 2004, five years after PGL was notified of the violation, PGL failed to perform 87,762 inspections, or approximately 30% of the total ISIs needed for compliance. (Id., 12-13.)

On December 19, 2007, the Commission entered its Interim Order in Illinois Commerce Commission On Its Own Motion -vs- Peoples Gas Light and Coke Company: Determination of the necessity for and the funding of a public awareness program regarding inside safety inspections, ICC Docket No. 07-0358. (Staff Ex. 3.0, 13.) That proceeding examined the overall difficulty PGL has had and continues to have regarding

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<sup>10</sup> There is a different standard for offshore pipelines. (49 C.F.R. §192.481(a).) As PGL has no such pipelines, this standard has no application here.

its ability to gain access to inside gas meters for proper inspection. Id. Due to that difficulty, PGL provided a plan to complete ISI inspections going forward and for authorization to petition USDOT for two waivers that would extend the time frame for inspecting the inside piping for atmospheric corrosion. Id. Proceedings in Docket No. 07-0358 were suspended pending the outcome of the waiver process. Id.

On March 25, 2009, the Commission entered a final order in Peoples Gas Light and Coke Company: Application for Partial Waiver of 49 CFR Sections 192.481 and 192.723, ICC Docket No. 08-0028, approving the waivers requested and received by PGL from PHMSA that extended the amount of time PGL may take to conduct an atmospheric corrosion inspection, and shortened the time PGL may take to conduct a leakage survey, of inside piping. (Staff Ex. 3.0, 13) The two waivers reconcile the timing of the atmospheric corrosion inspection and leakage survey to allow for either to be completed in three calendar years not to exceed 51 months. Id.

On March 15, 2011, Pipeline Safety Program Staff issued a NOPV to PGL for failure to adequately comply with 49 C.F.R. §§192.723 and 192.481(a). (Staff Ex. 3.0, 13.) PGL's NOPV response indicated that, once a single inside meter was inspected, then its procedure was to consider that the remaining meters located throughout the building need not be inspected. (Id., 13-14.) PGL's NOPV response also requested 3 years to come into compliance with additional inspections, which was agreed to. (Id., 14.)

PGL stated that it may be unable to comply with Staff's proposed condition due to the large volume and types of customers requiring an ISI. (Staff Ex. 3.0, 14.) Most meters requiring such an inspection were in locations where multiple meters existed and obtaining access to all meters was difficult. Id. Ultimately, however, PGL asserted that it

had come into compliance by the date required, June 30, 2014, although an audit of the ISI records to determine if the statements by PGL are correct has not, as of the date of Staff direct testimony, been conducted. Id.

In summary, then, it has taken – assuming that PGL is now in compliance – the Company approximately fourteen years to accomplish compliance. (Staff Ex. 3.0, 14.) This is clearly well in excess of what is permitted by federal regulations.

This problem may be attributable to any of several causes, but the main cause has been PGL's difficulty in gaining access to locations where the inside meters are located. (Staff Ex. 3.0, 14.) With respect to single family residences this may be due to some customers not wishing to permit anyone entry to their residences, for a variety of possible reasons, but access to these locations is not the most significant issue. Id. The most significant problem is where multiple meters and customers are located within one building. Id. Such meters may be in different locations, as, for example, in an apartment building where separate meters for each apartment are located in those apartments. Id. To complete the inspection, each meter in each apartment must be inspected. (Id., 14-15.) Accordingly, each tenant in each such building must individually provide access for PGL inspections for that single location to be considered completely inspected. (Id., 15.) The more meters in a building, the greater the difficulty of achieving complete compliance becomes. Id.

JAs assert that it is not feasible to move all meters outside. (JA Ex. 11.0, 7.) However, this assertion bears little scrutiny. When PGL installs new service, it has been observed that in some cases PGL allowed the meters to remain indoors at the customer's request. Id. PGL has the right to access its meters and any decision about meter location

should not be left to the customer, unless PGL is confident that access can be easily gained to conduct an ISI or any other type of work required on the service line or meter set. Id.

PGL further contends that it is difficult to locate business meters outside, contending that: “a business that abuts the sidewalk or other public way may have no suitable location for an outdoor meter.” (JA Ex. 11.0, 9.) However, PGL does indeed have meters located either in the front of or in the rear of businesses that would be considered to be in the public right-of-way. (Staff Ex. 11.0, 3.) Although it may not be an ideal solution to install a meter either in front or in the rear of a business, what is absolutely essential is to place the meter in a location that will allow PGL access now and in the future. (Id., 3-4.)

When replacing or installing a service pipe to a building, whether it is a residence or a business, it is not clear PGL always moves the meter to an outdoor, accessible location. (Staff Ex. 10.0, 4.) PGL asserts that not all meters can be moved, but this assertion may be little more than a rationalization to avoid locating meters outside. Id. The record in this proceeding demonstrates that PGL’s concerns are overstated. Where a service pipe was replaced as a part of AMRP, and the service pipe was associated with only one meter, PGL moved the inside meter to the outside 93.7% of the time. (Id. and Att. A) In the case of service pipes associated with 2 to 4 meters, PGL moved the meter outside 74.9% of the time. Id. Finally, in the case of service pipes associated with more than 4 meters, PGL moved the meter outside only 30.8% of the time. Id.

It is not clear why each meter that was located inside remained inside. As part of AMRP, PGL must either move each meter outside where there is no assurance that inside

access is, or will be, guaranteed or move the meter to a location inside where access by PGL is guaranteed. (Staff Ex. 10.0, 4.) The objective of meter placement is to provide PGL with unencumbered access to meters of any kind, so that it can conduct required safety inspections. Id.

PGL contends that inside meters are not *per se* inaccessible. (JA Ex. 11.0, 9.) PGL argues that inside meters are accessible in multi-unit buildings where there is staffing 24 hours per day, commercial buildings staffed during business hours, and multi-unit buildings that have a landlord or property manager who can provide access. Id.

While it is reasonable to conclude that inside meters in these specific, discrete classes of buildings may be accessible for inspection and need not be moved outside, (Staff Ex. 10.0, 5) this does not by any means resolve the entire problem. The record reflects that PGL has gone so far as to at least consider disconnecting customers' gas service due to its inability to obtain access to conduct ISIs of customers' premises. Id. It is apparent that PGL has difficulties obtaining access to its own gas meters located inside customer's residences and/ perhaps commercial or business locations. Id.

PGL next contends that moving meters supplied by the low pressure cast iron main system outside will result in reduced reliability of services, because cast iron main systems are susceptible to water infiltration. (JA Ex. 11.0, 9-10.)

This concern is not unreasonable. Accordingly, in order to protect the interests of PGL and its customers, consistent with Section 7-204(f) of the Act, PGL should be required as a condition of approval of the transaction to move all meters from inside to the outside when accessibility is, or may become a concern when PGL is replacing cast iron or ductile iron pipelines as part of AMRP. (Staff Ex. 10.0, 6.) These meters must be

moved as part of AMRP, but no later than 2030. Id. Such a requirement should also assuage PGL's concerns regarding cost, potential inefficiency, and conflict with AMRP. (See JA Ex. 11.0, 9-10.)

PGL has encountered meter accessibility issues for at least the past fourteen years in attempting to meet its ISI obligations relating to 49 C.F.R. §§192.481 and 192.723. (Staff Ex. 10.0, 7.) Not only has it taken PGL 14 years to complete the ISIs, there is no reason to suppose this will not be a continuing problem. Id. If PGL remains unable to complete the ISIs in a timely manner going forward, then monetary penalties should be imposed. Id. In an effort to alleviate the issue with accessibility of indoor meters where access is not guaranteed, the Commission should direct PGL to move indoor meters to the outside. Id. If the indoor meters are associated with pipe to be replaced as part of AMRP, then those meters can be moved in the course of associated AMRP work, but no later than 2030. Id. If there are inside meters that are not associated with pipe to be replaced as part of AMRP, and accessibility is an issue, then those meters should be moved outside, or to a location indoors where access by PGL is guaranteed, within 10 years of the date of the Commission Order in this proceeding. (Id., 7-8.) In addition, with respect to large multi-unit buildings with 24-hour staff, multi-unit buildings with landlords or property managers on the premises who have a right to access the units, and commercial buildings that are staffed during normal business hours, those meters need not be required to be moved to the outdoors and may be allowed to remain in the current location, providing those meters remain accessible to PGL personnel. (Id., 8.)

In its initial brief, the JAs propose the following condition regarding the relocation of inside meters:

With respect to indoor meters that are associated with pipe to be replaced as part of AMRP, the Joint Applicants agree that the decision process for leaving meters inside, or not centrally located, needs to be based on a common set of expectations that are uniformly applied. Within six months after the close of the Reorganization, the Joint Applicants will develop a new process for Staff review, with standard criteria and approvals, describing when Peoples Gas will allow a meter to stay inside or in a decentralized location. Peoples Gas will implement the new process and, as part of its discussions with Staff, work on developing and implementing refinements to the process.

(JAs' IB, Appendix A, #15.) From this proposal, it appears to Staff that Peoples Gas proposes to prepare a plan, without input from Staff, providing the bases pursuant to which Peoples Gas will or will not move a meter. In essence, JAs' condition language would give Peoples Gas a unilateral basis for never moving certain meters. Staff's language on the other hand, requires that inside meters will either be moved outside, or to an accessible location, within certain time frames. Staff's condition language is the only condition which guarantees that all inside meters, after a certain point in time (2030 for meters associated with AMRP and within 10 years for non-AMRP), will be accessible to Peoples Gas. For these reasons, the Commission should reject JAs' condition #15, and instead adopt Staff's condition #4 from Appendix B to Staff's Initial Brief, which is as follows:

Any meter that is part of AMRP should be moved outside or to an accessible location inside as part of AMRP by no later than 2030. Any meter not part of AMRP today or going forward must be moved outside or to an accessible location inside within 10 years. (Staff IB, Appendix B, #4.)

In the alternative, if the Commission believes that there may be some instances where some inside meters should not be moved, Staff proposes modifications to the JAs' proposed condition #15. Staff's modifications address the situation where Staff and Peoples Gas are unable to reach a common agreement on the process for determining

whether certain meters remain inside, or are not relocated to an accessible inside location. The JAs' proposed condition #15 assumes that Staff and Peoples Gas will be able to reach complete agreement on the process for determining whether certain meters remain inside, or are not relocated to an accessible inside location. While Staff is hopeful that such a process can be worked out between it and Peoples Gas, it is possible that such agreement may not be reached. In the event Staff and Peoples Gas are not able to reach agreement, Staff recommends that Peoples Gas be required to file a petition with the Commission initiating a new docket seeking the approval of its process. In that proceeding, Staff and Peoples Gas would have the opportunity to provide testimony and argument supporting its proposed process, with the Commission ultimately deciding the issue.

Consistent with the above, as an alternative to condition #4 to Appendix B to Staff's Initial Brief, Staff proposes the following revisions shown in underline to JAs' condition #15 from Appendix A to JAs Initial Brief, concerning Peoples Gas' inside meters:

With respect to indoor meters that are associated with pipe to be replaced as part of AMRP, the Joint Applicants agree that the decision process for leaving meters inside, or not centrally located, needs to be based on a common set of expectations that are uniformly applied. Within six months after the close of the Reorganization, the Joint Applicants will develop a new process for Staff review, with standard criteria and approvals, describing when Peoples Gas will allow a meter to stay inside or in a decentralized location. If Staff and Peoples Gas are unable to reach agreement on a process for leaving some meters inside or not relocating all meters to an accessible inside location, then Peoples Gas shall file a petition no later than eight months after the close of the transaction for the initiation of a new docket seeking approval of its proposed process. In that new proceeding, Staff and Peoples Gas will have the opportunity to provide testimony and argument supporting its proposed process for Commission consideration. Regardless of whether Staff and Peoples Gas reach complete agreement on the process or the Commission ultimately decides on the process to be implemented, Peoples Gas will implement the new process and, as part of its discussions with Staff, work on developing and implementing refinements to the process.

## **B. Section 7-204 Issues Resolved with JAs**

### **1. 7-204(b)(2) and (b)(3)**

In order to approve the JAs' reorganization, the Commission must find under Section 7-204(b)(2) that there is no unjustified subsidization of non-utility activities by the utility or its customers and the Commission must find under Section 7-204(b)(3) that there is a fair and reasonable allocation of costs and facilities between the utility and non-utility activities and the facilities and costs must be identifiable and properly included for ratemaking purposes. (See 220 ILCS 5/7-204(b)(2), (b)(3); *see also, generally*, Staff Ex. 6.0.) As part of any reorganization application and as required by the Act, the Joint Applicants requested approval under Section 7-101 and 7-204A for the WEC Energy Group Affiliated Interest Agreement. ("WEC Energy Group AIA") (Application, 25; JAs Ex. 2.4.) The WEC Energy Group AIA is a two-way agreement that provides the mechanism for charges from Wisconsin Energy companies to Integrys companies, including Peoples Gas and North Shore, and by Integrys companies, including Peoples Gas and North Shore, to Wisconsin Energy companies. (Staff Ex. 6.0, 3-4) The WEC Energy Group AIA includes various reporting and auditing requirements and is based upon the Gas Companies' Affiliated Interest Agreement approved in Docket No. 10-0408. ("10-0408 AIA") (Id., 4) The WEC Energy Group AIA and 10-0408 AIA come into play when addressing the issues of: (1) whether there is unjustified subsidization of non-utility activities by the utility or its customers (220 ILCS 5/7-204(b)(2)); and (2) whether costs and facilities are fairly and reasonably allocated between utility and non-utility activities and whether those costs and facilities are identifiable and properly included for ratemaking purposes (220 ILCS 5/7-204(b)(3)).

The Commission has a pending investigation in Docket Nos. 12-0273/13-0612 (Cons.) (“10-0408 AIA Investigation”) of the 10-0408 AIA. (Staff Ex. 6.0, 4.) In the initiating order for Docket No. 13-0612, the Commission broadened the scope of Docket 12-0273 and found:

that an investigation should be initiated to consider interactions between the companies and their affiliates, consistent with the recommendations in the Staff Report: North Shore Gas Company and The Peoples Gas Light and Coke Company, ICC Initiating Order Docket No. 13-0612, 2 (November 6, 2013)

The Commission should approve, as part of its order in Docket No. 14-0496, the following plan proposed by Staff (Staff Ex. 6.0 and 12.0) and agreed by JAs (JAs Ex. 16.0, 6) to enable the Commission to make the findings required by Sections 7-204(b)(2) and 7-204(b)(3):

- The proposed WEC Energy Group AIA shall be approved on an interim basis until the Commission has approved a new affiliated interest agreement in an order in the pending Docket Nos. 12-0273/13-0612 (Cons.); and
- The resulting affiliated interest agreement approved by the Commission in Docket Nos. 12-0273/13-0612 (Cons.) shall replace the existing 10-0408 AIA as the governing document of affiliated transactions between the Joint Applicants.

Further, the JAs have agreed with Staff<sup>11</sup> that the Commission should condition its approval of the transaction upon the following conditions:

- 1) Joint Applicants must provide to the Manager of the Commission’s Accounting Department and file on the ICC’s e-Docket system in Docket No. 14-0496, a copy of the signed, executed Interim Agreement that is being approved by the Commission in this proceeding, within 60 days after the date of the transaction (JAs Ex. 15.1 REV#22; Staff IB, Appendix A, #12);
- 2) Joint Applicants must provide to the Manager of the Commission’s

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<sup>11</sup> Conditions 1 through 5 below are included in JA Ex. 15.1 REV, Commitments Made and Conditions Agreed To By the Joint Applicants (through Surrebuttal Testimony) as Conditions 22 through 26.

Accounting Department and file on the ICC's e-Docket system in Docket No. 14-0496 a copy of the signed, executed Final Agreement pursuant to the Commission order in Docket Nos. 12-0273/13-0612 (Cons.) if there are any changes between the Interim Agreement and a Final Agreement (JAs Ex. 15.1 REV #23; Staff IB, Appendix A, #13);

- 3) The Gas Companies must supplement the information provided annually in their Form 21 ILCCs to the Commission with the following information on page 47 of Form 21 ILCC, beginning with the 2014 information to be submitted by March 31, 2015:

Column A – A breakdown of affiliated transactions by functional area grouped by direct billed versus allocated costs

Column B – Name of associated/affiliated company providing or receiving the service

Column C – Account that charges from associated/affiliated company are booked if the costs would have originated at the utility

Column D – Amount for the year

Column E – Docket number and regulatory authority approving the transaction

Column F – Footnote referencing the applicable exhibits from the affiliated interest agreements

(JAs Ex. 15.1 REV #24; Staff IB, Appendix A, #14)

- 4) Joint Applicants must file a semi-annual compliance report on the ICC's e-Docket system in Docket No. 14-0496, reporting the status of its progress of all conditions imposed by the Commission in this case. This reporting requirement shall remain in effect until all conditions have been satisfied or the Joint Applicants petition the Commission and receive approval to cease such reporting requirement, whichever comes first (JAs Ex. 15.1 REV #25; Staff IB, Appendix A, #15); and
- 5) The Chief Executive Officer of WEC Energy Group must, on an annual basis, appear before the Commission to report on the status of the Joint Applicants' compliance with the Order in Docket No. 14-0496 and to continue to appear until all conditions have been satisfied or the Joint Applicants petition the Commission and receive approval to cease such appearance requirement, whichever comes first.(JAs Ex. 15.1 REV #26; Staff IB, Appendix A, #16)

If the plan and conditions discussed above are acceptable to the Commission, the Commission should make the following findings in its order in Docket No. 14-0496:

- 1) Subject to the Commission's conclusions in Docket Nos. 12-0273/13-0612 (Cons.), find that the Joint Applicants are in compliance with Section 7-204(b)(2) of the Act, such that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers; and
- 2) Subject to the Commission's conclusions in Docket Nos. 12-0273/13-0612 (Cons.), find that the Joint Applicants are in compliance with Section 7-204(b)(3) of the Act, such that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities that are properly included by the utility for ratemaking purposes.

As the plan and conditions discussed above are all agreed to by the JAs, there is no dispute between the two parties with respect to Sections 7-204(b)(2) and (b)(3) and Section 7-101. No other parties testified on the above issues.

## **2. 7-204(b)(4)**

Section 7-204(b)(4) of the Act provides that, to approve the transaction, the Commission must find that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure." (220 ILCS 5/7-204(b)(4).) The proposed transaction satisfies this statutory requirement.

Standard & Poor's ("S&P") has assigned the Gas Companies an A- issuer rating, indicative of an obligor with a strong capacity to meet its financial commitments. (Staff Ex. 7.0, 4.) Moody's Investors Service ("Moody's") has assigned the Gas Companies an A2 issuer rating, which Moody's considers upper-medium grade and subject to low credit risk. (Id.) Following the merger announcement, S&P, whose ratings generally reflect a group credit profile, revised the Gas Companies' credit outlook from stable to negative due to the weakened financial measures at WEC resulting from the increased debt used to finance the transaction. (Id., 5.) Likewise, Moody's, whose ratings reflect a stand-

alone credit profile, also notes that “the amount of holding company debt compared to Integrys’ consolidated indebtedness will remain significant.” (Id., 5-6.) However, Moody’s apparently does not expect the transaction to have a detrimental effect on the Gas Companies’ stand-alone credit profiles, as it maintained the Gas Companies’ stable rating outlook. (Id., 6.)

While the Gas Companies might be assigned a lower S&P long-term issuer credit rating than today as a result of the proposed reorganization, it will likely be no lower than BBB+. (Staff Ex. 7.0, 6.) BBB+ rated utilities, while slightly less creditworthy than an A– utility, still have access to the long-term capital markets on reasonable terms. Id. As such, the effect of the proposed reorganization on the Gas Companies’ long-term credit ratings will not significantly impair their ability to raise necessary *long-term* capital on reasonable terms. (Id., 6.)

Additionally, the Joint Applicants intend to maintain the Gas Companies’ current sources of short-term debt, including their money pool with each other and Integrys; Peoples Gas’s credit facility, which does not expire until June 2017; and Peoples Gas’s commercial paper program. (Staff Ex. 7.0, 8.) Further, it is unlikely that the proposed reorganization will harm Peoples Gas’s commercial paper rating. As such, the proposed reorganization will not significantly impair the Gas Companies’ ability to raise necessary *short-term* capital on reasonable terms. Id. Thus, the proposed reorganization satisfies Section 7-204(b)(4) of the Act.

### **3. 7-204(b)(5)**

Section 7-204(b)(5) of the Act specifically requires that, in reviewing any proposed reorganization, the Commission must find that the utility will remain subject to all

applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. JAs state Peoples Gas and North Shore will each remain Illinois public utilities following the Reorganization and will, therefore, remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. (JAs' Application, 21.)

Additionally, Section 7-204(b)(5) of the Act is explicitly addressed in the direct testimony of Mr. Allen L. Leverett, President of Wisconsin Energy Corporation. (JAs' Ex. 1.0, 16.) Mr. Leverett states that the Peoples Gas and North Shore Gas will retain their current names, will continue to operate as Illinois public utilities in their current service areas, will retain their current Illinois headquarters, and will continue to be subject to Commission jurisdiction and applicable Illinois law and regulations. Id. Staff finds JAs meet the requirement of Section 7-204(b)(5) of the Act. (Staff Ex. 1.0, 7.)

#### **4. 7-204(b)(6)**

Section 7-204(b)(6) of the Act requires the Commission to find that "the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction." (220 ILCS 5/7-204(b)(6).) The relevant markets which the Commission needs to be concerned with are not just the gas markets but rather all competitive retail utility markets in the state, which includes gas and electric. (Staff Ex. 4.0, 5.) The Commission must consider any effect this Reorganization might have on any retail electric markets in Illinois or the retail gas markets in other utility service territories. Id. A significant adverse impact on competition "would likely increase the ability of a firm or firms in the market to, all else equal, increase prices above costs." Id. A review of the JAs' testimony and response to

data requests reveals that the proposed reorganization is not likely to have a significant adverse effect on competition the Commission should find the JAs had met the requirement of Section 7-204(b)(6) of the Act. (Id., 4.)

#### **5. 7-204(b)(7)**

Section 7-204(b)(7) of the Act provides that, to approve the transaction, the Commission must find that “the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.” (220 ILCS 5/7-204(b)(7).) It is not clear whether the Gas Companies’ costs of capital are likely to increase because of the proposed reorganization, but it is certainly possible. (Staff Ex. 7.0, 9.) Specifically, as a consequence of the proposed reorganization, the Gas Companies’ credit ratings have been assigned a negative rating outlook from S&P. Id. If their credit ratings are ultimately downgraded, it would lead to higher capital costs, which would have an adverse impact on rate payers. (Id., 10.) In order to mitigate the effects of a potential credit rating downgrade of WEC, Staff initially recommended that the Commission apply the following conditions to any approval of the proposed reorganization:

- Require Peoples Gas and North Shore to maintain separate credit facilities, not accessible to nor influenced by non-utility affiliates;
  - Prohibit Peoples Gas and North Shore from lending to non-utility affiliates under Section 7-101 of the Act or Illinois Administrative Code Part 340;
  - Prohibit Peoples Gas and North Shore from guaranteeing any obligations of their non-utility affiliates;
  - Require WEC to notify the Commission before increasing its proportion of non-regulated operations and indebtedness; and
  - Require Peoples Gas and North Shore to register with the U.S. Securities and Exchange Commission (“SEC”) or to present a detailed study showing costs and savings of registration compared to remaining unregistered.
- (Staff Ex. 7.0, 9-10.)

The first three conditions were designed to insulate the Gas Companies from their non-utility affiliates, thereby reducing the risk that the obligations of these new non-utility

affiliates would adversely affect the Gas Companies' financial health. (Staff Ex. 7.0, 11.) Similarly, the fourth condition would permit the Commission to assess whether further action would be necessary to insulate the Gas Companies from their affiliates, should WEC Energy Group decide to increase the potential influence of non-utility investments of parent company indebtedness. (Id., 11-12.) Finally, the fifth condition could offset any increase in the Gas Companies' costs of capital due to a ratings downgrade by increasing the liquidity of the Gas Companies' debt securities. Id.

Although the Joint Applicants initially raised objections to some of those conditions, they ultimately agreed to the conditions, with some modifications. The following is the language agreed to for those conditions:

- Peoples Gas and North Shore are to maintain separate credit facilities to the extent they existed prior to the entry of the final Order in this proceeding approving the Reorganization, not accessible to nor influenced by non-utility affiliates; (JA Ex. 16.0, 8; JAs Ex. 15.1 REV #24; Staff IB, Appendix A, #17.)
- Prohibit Peoples Gas and North Shore from lending to non-utility affiliates under Section 7-101 of the Act or Illinois Administrative Code Part 340; (JA Ex. 7.0, 15-16; JAs Ex. 15.1 REV #28; Staff IB, Appendix A, #18)
- Prohibit Peoples Gas and North Shore from guaranteeing any obligations of their non-utility affiliates; (JA Ex. 7.0, 16; JAs Ex. 15.1 REV #29; Staff IB, Appendix A, #19)
- The WEC Energy Group shall file with the Commission, within 90 days after the closing of the Reorganization, a report detailing the debt held at the WEC Energy Group holding company and Integrys sub-holding company levels, its relationship to total holding company debt and any company plans to reduce the debt, along with WEC Energy Group's proportion of non-regulated operations in terms of total investment, revenues, and operating income, with updated reports to be filed annually until the Joint Applicants petition the Commission and receive approval to cease such reporting requirements; (JA Resp. to Staff DR MGM 5.02; Staff IB, Appendix A, #20) and

- Peoples Gas and North Shore shall present a detailed study within six months after the close of the Reorganization showing the costs and savings of U.S. Securities Exchange Commission registration compared to remaining unregistered. (JA Ex. 16.0, 9; JAs Ex. 15.1 REV #32; Staff IB, Appendix A, #21.)

With these conditions, the Joint Applicants' Petition will satisfy the requirements of Section 7-204(b)(7) of the Act, and the Commission should apply those conditions to any approval of the proposed reorganization.

## **6. 7-204(c)**

Section 7-204(c) of the Act states that:

The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.

The proposed reorganization complies with these requirements.

The JAs do not expect the savings to occur until five to ten years after the reorganization and assert that savings to be achieved in the future will flow through to ratepayers in future rate cases. (Staff Ex. 5.0, 3.) The JAs also state that they will not seek recovery of costs incurred to accomplish the reorganization from customers and also commit to not seek recovery from customers of the acquisition premium paid as part of the reorganization in rate base, nor the amortization of the premium in future cost of service determinations. (Id., 3-4.)

The JAs have agreed that the allocation of any savings resulting from the proposed reorganization will flow through to ratepayers. (Staff Ex. 11.0, 3.)

The JAs have further agreed that they will not seek recovery of costs incurred to accomplish the proposed reorganization. (Staff Ex. 11.0, 3.) “Transaction costs”<sup>12</sup> are costs incurred to accomplish the proposed reorganization and are not recoverable. (Staff Ex. 11.0, 3; JAs Ex. 8.0, 18.) “Transition Costs”<sup>13</sup> are costs incurred to achieve long-term efficiencies and savings and may be recoverable to the extent the transition costs do not exceed the savings the transition costs produce. Id.

The Gas Companies should be directed to separately identify and track transaction costs and transition costs. (Staff Ex. 11.0, 3.) The Joint Applicants agree that, in future rate cases, all costs included in the test period resulting from accomplishing the reorganization (transaction costs) would be identified and such costs would be shown to not be included in the rate case for recovery. (Id., 4)

Given the above, Staff proposed the following conditions which the JAs agreed to:

- The allocation of any savings resulting from the proposed reorganization shall flow through to ratepayers. (JA Ex. 15.1 REV. #19; Staff IB, Appendix A, #9.)
- Transaction costs incurred in accomplishing the proposed Reorganization shall not be recoverable from ratepayers. (JA Ex. 15.1 REV. #20; Staff IB, Appendix A, #10.)
- In future rate cases, the Gas Companies shall identify all transaction costs included in the test period that result from accomplishing the Reorganization

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<sup>12</sup> Examples of Transaction Costs include costs associated with executing the transaction such as banker’s fees, legal fees, severance package costs (i.e., executive change-in-control payments as identified in an SEC Form S-4). (JAs Ex. 8.0, 18.)

<sup>13</sup> Examples of Transition Costs include: future severance package costs, corporate restructuring costs, relocation costs, and accounting and IT integration costs. (JAs Ex. 8.0, 18.)

and demonstrate that such costs are not included in the rate case for recovery. (JA Ex. 15.1 REV. #16; Staff IB, Appendix A, #6.)

- The Gas Companies shall separately identify and track transaction costs and transition costs. (JA Ex. 15.1 REV. #17; Staff IB, Appendix A, #7.)
- In future rate cases, transition costs may be recoverable to the extent the Transition Costs produce savings. (JA Ex. 15.1 REV. #21; Staff IB, Appendix A, #11.)

**C. Section 7-101 and Section 7-204A**

See, discussion of Section 7-204(b)(2) and (b)(3)

**D. Section 6-103 and 9-230**

Section 6-103 of the Act requires that in any reorganization, the Commission shall authorize the amount of capitalization of a public utility formed by a reorganization, which shall not exceed the fair value of the property involved. (Staff Ex. 7.0, 12.) In prior merger/acquisition proceedings involving Illinois utilities, the Commission has preemptively addressed concerns regarding potential violations of Section 9-230, which prohibits the Commission from reflecting in a utility's rates any incremental risk or increased cost of capital which is the result of a public utility's affiliation with non-utility companies. Id. Similarly, in a recent discussion of this proceeding, as it relates to the Gas Companies' ongoing rate setting proceeding, the Commission cited the influence that WEC Energy Group's capital structure might have on the Gas Companies' financial condition and capital structures. Id. WEC has chosen to fund the proposed transaction by significantly increasing its debt obligations at the corporate level, which creates higher financial leverage at the parent than at the operating companies and increases the risk to the operating companies, potentially necessitating a rate of return adjustment pursuant to Section 9-230. Id.

As such, as a condition of any approval of the proposed reorganization, the Commission should require the Gas Companies to file a compliance report with a copy to the Manager of the Commission's Finance Department following the proposed reorganization that describes the Gas Companies' post-merger capital structures and identifies capital structure adjustments that result from the proposed reorganization. (Staff Ex. 7.0, 15.) No further action would be required with regard to this recommendation if the Gas Companies' post-merger capital structures do not involve any push down accounting adjustments. Id. On the other hand, if there are push down accounting adjustments to the Gas Companies' balance sheets, then the Commission should also require the Gas Companies to file a petition seeking Commission approval of the fair value studies and resulting capital structures for the Gas Companies' pursuant to Section 6-103 of the Act. Id.

The Joint Applicants agreed, generally, to this proposed condition, but presented the following alternative language:

- The Gas Companies shall file a compliance report in Docket No. 14-0496 within 180 days after the close of the Reorganization, with a copy to the Manager of the Commission's Finance Department, that describes the Gas Companies' post-merger capital structures and identifies capital structure adjustments, if any, that resulted from the Reorganization. In the event that there are push-down accounting adjustments made to the Gas Companies' balance sheets as a result of the Reorganization, then the Gas Companies shall file a petition with the Commission seeking Commission approval of the fair value studies and resulting capital structures for the Gas Companies pursuant to Section 6-103 of the Act.

(JA Ex. 7.0, 4; Staff IB, Appendix A, #22.) Staff recommends this language be adopted.

(Staff Ex. 13.0, 4.)

It is unlikely that the transaction, as proposed, will comply with Section 9-230 of the Act. (Staff Ex. 7.0, 15-16.) The fact that S&P has assigned Peoples Gas and North

Shore a negative rating outlook indicates that the Gas Companies' credit rating could be downgraded as a result of the proposed reorganization. (Id., 16.) Such a downgrade would likely increase the Gas Companies' cost of capital, which would necessitate an adjustment to the authorized rate of return pursuant to Section 9-230 if not properly addressed beforehand. Id. A credit rating downgrade notwithstanding, a Section 9-230 adjustment would be necessary because there is a limited debt capacity at the consolidated level, which means that the Gas Companies cannot take full advantage of their debt capacities without jeopardizing WEC Energy Group's current credit ratings and their own S&P credit ratings due to S&P's practice of aligning subsidiary credit ratings with those of the parent company. Id. Adjusting the Gas Companies' capital structures is a reasonable method for addressing this issue, particularly in light of the greater financial leverage expected at WEC Energy Group (56% debt) compared to Peoples Gas (49.52% debt) and North Shore (49.67% debt). Id. As such, Staff initially recommended that the Commission require a study of appropriate post-merger capital structures for Peoples Gas and North Shore, similar to those ordered in Docket Nos. 11-0721 and 12-0001. Id. The study, to be performed by the Gas Companies under the guidance of the Commission's Finance Department Manager, was proposed to commence no later than six months prior to, and be presented to the Commission in final form at the time of or before, the filing of the Gas Companies' next rate case. (Id., 16-17.)

The Joint Applicants agreed to a modified version of the condition, as follows:

- Peoples Gas and North Shore shall perform a study of their appropriate post-merger capital structures, similar to those ordered in Docket Nos. 11-0721 and 12-0001. Commonwealth Edison Co., Order, ICC Docket No. 11-0721, 134 (May 29, 2012); Ameren Illinois Co., Order, ICC Docket No. 12-0001, 121 (September 19, 2012). The study, to be performed by the Gas Companies under the guidance of the ICC's Finance Department Manager, should

commence no later than six months prior to, and be presented to the Commission in final form at the time of or before, the filing of the Gas Companies' next rate case.

(JA Ex. 16.0, 12-13; Staff IB, Appendix A, #23.) With the bulleted conditions above, the Joint Applicants' Petition would satisfy the requirements of Sections 6-103 and 9-230 of the Act, and the Commission should condition approval of the proposed reorganization on their adoption.

#### **E. Purchase Accounting Entries**

The Joint Applicants have elected to not follow push-down accounting for the Gas Companies; therefore, no purchase accounting entries are required. (Staff Ex. 11.0, 4.) Although the JAs are not electing to follow push-down accounting for the Gas Companies, the JAs and Staff agreed to the following condition:

Any accounting entries made to the books of the Gas Companies for push-down accounting related to the Reorganization shall be disregarded for ratemaking and regulatory reporting purposes. (JAs Ex. 15.1 REV. #18: Staff IB, Appendix A, #8.)

#### **F. Intervenors Proposed Merger Conditions Opposed by Staff**

##### **1. AG Proposed Riders**

The Commission should reject the AG's proposal that JAs' merger be conditioned on the Commission ordering that two riders be imposed on NS/PGL. (See Staff Ex. 12.0, 6-7) The JAs also objected to the AG's rider proposal. (JAs Ex. 6.0, 25-27, 41; JAs Ex. 9.0, 15-25.) Approving the AG's riders would be contrary to the law. While "the Commission has the power to authorize a rider in a proper case and such authorization will not be reversed absent an abuse of discretion" (Commonwealth Edison v. Illinois Commerce Comm'n, 405 Ill. App. 3d 389, 411 (2nd Dist. 2010)), neither of the two

proposed AG riders satisfies either requirement. The first AG rider is intended to address the difference between headcounts for the test year reflected in the revenue requirements presented by NS/PGL in their most recent rate cases, Docket Nos. 14-0224/0225, Cons. (“rate cases”) and the headcount approved in this reorganization case. (Staff Ex. 12.0, 6-7.) The second AG rider is intended to address the difference in costs of the Integrys Customer Experience (“ICE”) project reflected in the rate cases versus the ICE costs incurred if the reorganization is approved. Id. Under the law, the Commission only has the discretion to approve a rider mechanism if: (1) the cost is imposed upon the utility by external circumstances over which the utility has no control; and (2) the cost does not affect the utility’s revenue requirement. (Commonwealth Edison v. Illinois Commerce Comm’n, 405 Ill. App. 3d at 414.) That is, a rider is only appropriate, if the utility cannot influence the cost and the expense is a pass through item that does not change other expenses or increase income. Id. With respect to the first element of the Commonwealth Edison test, the AG has failed to show that the costs related to head counts and the ICE project are costs imposed by external circumstances over which NS/PGL has no control. With respect to the second element, the headcount costs and ICE project costs would have an impact NS/PGL’s revenue requirement, given that the base for determining the costs to be recovered through the rider are the costs approved in the recent NS/PGL rate cases.

Finally, in rebuttal, AG witness, Mr. Effron, testified that, “[c]onditioning approval of the merger of the adoption of the described rider[s] is not the same as ordering Peoples Gas and North Shore to adopt such a rider.” (AG Ex. 3.0, 2.) If by this testimony, the AG is suggesting that as long as the JAs do not object to the AG’s proposed rider conditions,

the Commission can include the riders as part of its order, this assertion is contrary to law, for either of two reasons. First, under the law, a Commission order must be consistent with and not violate the Act. (See, Business and Professional People v. ICC, 136 Ill. 2d 192, 217 (1989) (“Absent statutory law to the contrary, we have no quarrel with the Commission’s ability to *consider* a settlement proposal not agreed to by all of the parties and the intervenors as a decision on the merits, as long as the provisions of such a proposal are within the Commission’s power to impose, the provisions do not violate the Act, and the provisions are independently supported by substantial evidence in the whole record. Such was not the situation in the case at bar.”)) Since the AG’s rider proposals would violate the Act, the Commission cannot impose them even if they are agreed to by JAs.

Second, if the AG’s argument is indeed that a voluntary commitment to, or acquiescence in, a rider makes it lawful, this simply does not survive the *Commonwealth Edison* test. As noted above, to be properly recoverable under a rider, costs must be imposed by external circumstances over which a utility has no control. Yet, a utility has absolute control over whether it will accept a voluntary commitment, or not object to the imposition of one. Accordingly, the AG’s logic is fatally flawed, and its arguments must be rejected.

For these reasons, the Commission should reject the AG’s proposed riders for head counts and ICE project costs.

## **2. CITY/CUB Proposed Fixed Customer Charge Freeze**

City/CUB's proposal that the Gas Companies' fixed customer charges should be capped during the period of any rate freeze ordered by the Commission (City/CUB Ex. 2.0, 10.) appears to be a moot point in light of the recent Illinois Supreme Court decision in People of the State of Illinois ex rel. Madigan v. Illinois Commerce Commission, 2015 IL 1 16005, January 23, 2015. City/CUB made this proposal in response to a statement by JAs that if the Illinois Supreme Court reversed the Commission's prior order allowing Rider VBA (Volume Balancing Adjustment)<sup>14</sup>, NS/PGL might file a revenue neutral rate design case. (JA Ex. 6.0, 35.) Staff witness Alicia Allen opposed City/CUB's proposal. (Staff Ex. 14.0, 3.) On January 23, 2015, subsequent to the filing of JAs', Staff's and Intervenors' rebuttal testimonies, the Illinois Supreme Court upheld the Commission's prior order approving Rider VBA. Given the fact that the Illinois Supreme Court upheld Rider VBA, JAs have indicated that they no longer reserve the right to submit revenue neutral rate design proposals for the Gas Companies during the pendency of their rate freeze commitment and that this issue should be moot. (JAs Ex. 15.0, 3.) Staff agrees with JAs that this issue is moot.

## **3. AG Proposed Cap on Residential Revenue Recovery Through Fixed Charges**

The AG recommends as a condition to the JAs' reorganization, that there be a cap of 40% of the residential revenue requirement recovered through the residential fixed charges. (AG IB, 65-67.) In the Gas Companies' most recent rate cases, the Commission recently set new rates for the residential class where the fixed charges were lowered from

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<sup>14</sup> ILL. C.C. NO. 28, Sixth Revised Sheet No. 61, The Peoples Gas Light and Coke Company, Rider To Schedule Of Rates For Gas Service

those set in the prior rate cases. (North Shore and Peoples Gas, ICC Order Docket No. 14-0224/14-0225 (cons.) 176, January 21, 2015.) If the Commission wanted the fixed charge recovery of the revenue requirement to be set even lower than what it set in the most recent rates cases for the Gas Companies, it would have so ordered. The Commission should base its decisions about rate design on the evidence in each rate case and not impose an overall cap on the percentage of fixed cost recovery independent of cases-specific evidence. Staff recommends the Commission reject the AG's proposed condition.

## **G. Other**

### **1. JAs' List of All Commitments and Conditions Agreed to by JAs**

JAs' Initial Brief, Appendix A, lists all of the commitments and or conditions agreed to by the JAs as of the filing of initial briefs. With the exception of conditions/commitments: 2, 5, 14 and 15 (JAs IB, Appendix A), Staff does not oppose the commitments/conditions agreed to by JAs in JAs' Appendix A. JAs' Initial Brief, Appendix A, conditions/commitments 2, 5, 14 and 15 address issues raised by Staff, and as discussed above there is not complete agreement between Staff and JAs on those four issues.

Subsequent to the filing of initial briefs, the JAs agreed to two more conditions which were the subject of Appendix C to Staff's initial brief. The agreed to language is discussed below.

### **2. JAs' Other Finance Related Commitments With Staff**

Staff noted that, as a primary benefit of the proposed transaction, the JAs repeatedly cite their expectation that the Gas Companies will have enhanced access to capital markets on reasonable terms as a result of the scale of the newly formed

corporation. Staff concluded that, assuming this emphasis on the benefits of the greater scale of the newly formed corporation is warranted, it would be unnecessary to apply an adjustment to the cost of common equity in future rate cases on the basis of the Gas Companies' relatively small size. Thus, Staff recommended that the JAs commit to not seek recovery of any costs related to time spent by witnesses on the development or presentation of cost of common equity size adjustments in future rate cases. (Staff Ex. 7.0, 17-18.)

Staff and the JAs were able to reach agreement on a modified version of that commitment, as follows:

- The Joint Applicants commit not to seek recovery of any costs related to time spent by Gas Companies witnesses on the affirmative development or affirmative presentation of cost of common equity size adjustments for the Gas Companies in their future rate cases for as long as they are owned by WEC Energy Group, Inc. The Joint Applicants reserve the right to seek the recovery of costs associated with the defensive development or defensive presentation of information regarding cost of common equity size adjustments in future rate cases in the event that a party argues for a downward adjustment to the common equity of one or both of the Gas Companies based upon the size of the Gas Companies or their parent companies.

(JAs' Resp. to Staff DR MGM 5.06; Staff IB, Appendix A, #24.)

Finally, with respect to the JAs' argument that City-CUB witness Gorman's proposed condition to restrict dividends is unnecessary, as the Commission already is empowered to restrict dividends by Section 7-103 of the Act, Staff noted that, unlike Mr. Gorman's proposal, the authority granted the Commission under Section 7-103 is not preemptive. Therefore, Staff recommended that, if Mr. Gorman's proposed condition is rejected, the Commission should require the JAs to file copies of all credit rating agency reports for the Gas Companies and WEC Energy Group within five days of publication, so that the Commission can act on its authority under 7-103 in a timely manner should

those reports indicate a deterioration in the companies' creditworthiness. (Staff Ex. 13.0, 6-7.)

Staff and the JAs were able to reach agreement on a modified version of that condition, as follows:

- All credit reports and bulletins published by credit rating agencies specific to the Gas Companies and WEC Energy Group shall be filed with the Commission in this docket within 10 business days after being published, and in a manner consistent with the requirements for publication imposed by the copyright holders.

(JAs' Resp. to Staff DR MGM 5.05; Staff IB, Appendix A, #25.) Nonetheless, Staff is not taking any position on Mr. Gorman's proposal to condition dividends on AMRP targets.

#### **H. Commissioners' Data Request**

Consistent with the ruling by the ALJ, JAs provided responses to the Commissioners' data request on March 18, 2015. On March 24<sup>th</sup>, Staff filed its reply to the JAs' response which stated as follows:

To summarize the JAs' Responses, they have stated that they are aware of many significant modifications to the manner in which AMRP must be managed going forward to make it a successful project completed at a reasonable cost to ratepayers. The JAs have stated that steps are already being taken to improve management of AMRP, have indicated what those initiatives are, and have stated that they expect to examine the Liberty Final Audit report to identify opportunities to make further modifications. In particular, JAs propose to make certain changes in senior management structure. Whether or not the current and/or future initiatives and modifications will be effective can only be determined over the course of time, and the results will have to be examined by the Commission at some future time. The JAs' Responses do not bring to light any new information or matters which cause Staff to change any of its recommendations regarding the Commission's actions on the merger petition, or to alter any of its proposed merger conditions.

(Staff Reply, 1.)

**I. Staff's Proposed Post-Hearing Conditions Resulting From Commission-Initiated Investigation, Docket No. 15-0186**

Staff proposed two post-hearing conditions resulting from the investigation initiated by the Commission on March 11, 2015. (Staff IB, Appendix C) The investigation was a result of two anonymous letters sent to Commission Staff and attorneys in late February and early March. The anonymous letters allege mismanagement of the AMRP and criminal and fraudulent activity by several of the JAs. After receiving the first anonymous letter, a Staff Report urged the Commission to open a formal investigation, naming Peoples Gas as a respondent. The Commission's Corrected Initiating Order states:

The Staff Report includes the anonymous letter as an attachment and recommends the Commission initiate a formal investigation which would permit the parties involved in Docket No. 14-0496 to intervene and participate. The investigation would examine the veracity of the claims addressed in the letter as well as the safety concerns regarding the Peoples Gas natural gas distribution system in Chicago.

On March 9, 2015, the Commission received a second anonymous letter. The scope of the investigation initiated today will be expanded to also look into the allegations made in that letter. With a special emphasis on safety implications, this Commission will also investigate any further allegations of a similar nature as it pertains to the AMRP that may be disclosed in the future.

The Commission will conduct this proceeding as an investigation pursuant to its authority under Section 10-101 of the Public Utilities Act ("Act") and shall have all other authority and remedies granted to it under the Act, including without limitation, Articles 4, 5, and 9 and Section 8-102.

(Corrected Initiating Order, Docket No. 15-0186, March 11, 2015, 1-2.)

Concurrent with filing its Initial Brief, Staff filed a Motion to Request Administrative Notice of the Corrected Initiating Order in Docket No. 15-0186, consistent with Sections 200.190 and 200.640 a)2) of the Commission's Rules of Practice. 83 Ill. Adm. Code 200.190; 200.640 (a)(2). (See, generally, Staff's Motion for Administrative Notice of Corrected Initiating Order and Staff Report in Docket No. 15-0186.)

It is Staff's understanding that the JAs agree to the following Staff investigation related conditions:

1. In the event that the Commission determines, as a result of any investigation into the two anonymous whistleblower letters currently the subject of a Commission-initiated investigation in Docket No. 15-0186, that any of the Joint Applicants (including any of their employees, agents, contractors, or representatives) are responsible for misconduct or unlawful or criminal activity, then the Joint Applicants' shareholders shall be responsible for and shall not be permitted to recover through rates any expenses, costs, fines, penalties, fees or economic losses of any description whatever, however incurred, that the Commission determines to have arisen from such misconduct or unlawful or criminal activity. As used in this condition, the term "investigation" shall not be limited to Docket No. 15-0186, but shall encompass any other related state or federal investigation. As used in this condition, the term "misconduct" shall mean wrongdoing or disregard for compliance with applicable laws, rules, regulations, Commission Orders, and/or well-established industry standards. Wisconsin Energy and Integrys shall be permitted to enter into a contractual arrangement regarding this liability.

2. In the event that the Commission determines, as a result of any investigation into the two anonymous whistleblower letters currently the subject of a Commission-initiated investigation in Docket No. 15-0186, that an officer, employee, agent or representative of the Joint Applicants either (a) attempted to prevent from being accomplished or improperly influence the investigation of the AMRP being conducted by the Liberty Consulting Group pursuant to the Commission's final Order in Docket Nos. 12-511/12-0512 (cons.) or (b) committed material misconduct or unlawful or criminal activity, then Wisconsin Energy shall take all available and appropriate action(s) to terminate from employment or any contractual relationship that officer, employee, agent or representative of the Joint Applicants. As used in this condition, the term "investigation" shall not be limited to Docket No. 15-0186, but shall encompass any other related state or federal investigation. As used in this condition, the term "misconduct" shall mean wrongdoing or disregard for compliance with applicable laws, rules, regulations, Commission Orders, and/or well-established industry standards.

Based upon that understanding, Staff supports as conditions for the reorganization, the above language, instead of the two conditions contained in Appendix C to Staff's initial brief.

Respectfully submitted,

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JESSICA L. CARDONI  
JOHN C. FEELEY  
MATTHEW L. HARVEY  
Office of General Counsel  
Illinois Commerce Commission  
160 North LaSalle Street, Suite C-800  
Chicago, IL 60601  
Phone: (312) 793-2877  
Fax: (312) 793-1556  
jcardoni@icc.illinois.gov  
jfeeley@icc.illinois.gov  
mharvey@icc.illinois.gov

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*Counsel for the Staff of the  
Illinois Commerce Commission*